

To

All Scheduled Commercial Banks (excluding RRBs & LABs) and
Primary Dealers

Dear Sir,

Stripping/Reconstitution of Government Securities

Please refer to paragraph No.120 of the Annual Policy Statement for the year 2008-09. As indicated therein, it has been decided to introduce STRIPS [Separate Trading of Registered Interest and Principal of Securities] in Government Securities as part of the efforts to develop the Government Securities market.

2. STRIPS in Government Securities will ensure availability of sovereign zero coupon bonds, which will lead to the development of a market determined zero coupon yield curve (ZCYC). STRIPS will also provide institutional investors with an additional instrument for their asset-liability management. Further, as STRIPS have zero reinvestment risk (discounted instruments with no periodic interest payment thereby obviating the need for reinvestment of intermediate cash flows arising out of the investment), they can be attractive to retail/non-institutional investors.

3. The terms and conditions governing the stripping/reconstitution of securities issued by Government of India are set out in the RBI notification.

4. Detailed guidelines outlining the process of stripping/reconstitution and other operational aspects relating to transactions in STRIPS is enclosed.

Draft Guidelines on Stripping/Reconstitution of Government Securities

Stripping/Reconstitution

Stripping is a process of converting periodic coupon payments of an existing Government Security into tradable zero-coupon securities, which will usually trade in the market at a discount and are redeemed at face value. Thus, stripping a five-year security would yield 10 coupon securities (representing the coupons), maturing on the respective coupon dates and one principal security representing the principal amount, maturing on the redemption date of the five-year security. Reconstitution is the reverse of stripping, where, the Coupon STRIPS and Principal STRIPS are reassembled into the original Government Security.

2. In terms of Explanation to section 11(2) of the Government Securities Act 2006, “A Government security may be stripped separately for interest and principal or reconstituted on the application of the holder subject to such terms and conditions as may be specified”. Accordingly, the terms and conditions for stripping and/or reconstitution of Securities issued by the Government of India will be notified by Reserve Bank of India .

Process of Stripping/Reconstitution

3. Stripping/Reconstitution will be carried out at RBI as an automatic process within the PDO-NDS system. The process of stripping/reconstitution will be a straight-through process without any manual intervention. Requests for stripping/reconstitution will be generated by market participants on the NDS and submitted to a PD of their choice for authorization. After authorization by the PD, such requests would be received and processed by the system (PDO-NDS) and necessary accounting entries are posted in the accounts of the requesting participant for the STRIPS created/reconstituted. The NDS will do necessary validation check like eligibility of securities, balances available, etc., on the requests for stripping/reconstitution made by participants. However, participants are to ensure that sufficient balances are available in their accounts before putting through requests for stripping/reconstitution.

4. Normally, ISIN for Government Securities are assigned at the time of auction of the securities. However, in the case of STRIPS, as these securities are created at the request of the participant, ISIN as well as nomenclature for STRIPS are created automatically based on a predefined algorithm (see **Annex 1**).

Eligibility

5. Any entity, including individuals, holding balances of government securities that are eligible for stripping/reconstitution (as notified by RBI from time to time) can strip/reconstitute these securities. However, a participant desirous of stripping/reconstituting his balance of eligible government securities should approach a Primary Dealer with a request for stripping/reconstitution. Since stripping/reconstitution is permitted only on SGL (demat) securities, any participant desirous of stripping/reconstituting Government Securities must open and maintain a demat account (SGL A/c or a Gilt A/c with a constituent) and hold government securities in electronic form. In the case of Primary Dealers, they can place request for stripping/reconstitution directly into NDS for stripping/reconstitution and need not route the same through another PD.

6. Initially, all PDs would be eligible to authorize stripping/reconstitution requests. However, Reserve Bank, at its discretion, can exclude any PD from authorizing such requests. Market participants will have the flexibility to choose a PD of their choice while submitting requests for stripping/reconstitution. PDs will act as market makers in STRIPS and provide two-way quote in the market.

Timings

7. Requests for stripping/reconstitution can be submitted by participants between 9.00 am and 2.00 pm only. All requests for stripping/reconstitution, received by the system (PDO-NDS), will be processed at 2.00 pm and necessary book entries will be passed in the SGL account of the participant to credit/debit the due amount of STRIPS (coupon as well as principal) on account of stripping/reconstitution. Stripping requests cannot be made/ posted after 2.00 pm on any business/working day.

8. Similarly, requests for reconstitution can be submitted between 9.00 am and 2.00 pm only. However, the requests for reconstitution would be processed online, i.e., as and when such requests are authorized by the PD and hence the necessary entries would be passed in the SGL account of the requesting participant immediately subject to availability of sufficient and necessary balances. However, as indicated at paragraph 7 above, no requests for reconstitution would be received/ processed after 2.00 pm.

Eligible Securities

9. To begin with, securities issued by Government of India with coupon dates as 2nd January and 2nd July will be eligible for stripping/reconstitution. Thus, all outstanding securities issued by Government of India with coupon dates/maturity date as 2nd January and 2nd July, irrespective of the year of maturity, will be eligible for stripping/reconstitution.

Minimum amount for stripping/reconstitution

10. The minimum amount of securities that needs to be submitted for Stripping/Reconstitution will be Rs.1 crore (face value) and multiples thereof.

Accounting and Valuation

11. Accounting entries in the SGL accounts due to stripping/reconstitution will be carried out at the face value. Thus, when a member places a request for stripping, his SGL account is debited for the face value of the government security submitted for stripping and is credited with face value of Coupon STRIPS (equal to the coupon amount) and Principal STRIPS (equal to the principal amount submitted for stripping). An illustration of the entire process is given in **Annex 2**. However, STRIPS should be accounted in the books of account of the participant at the discounted value.

12. In such cases where STRIPS are acquired by submitting request for stripping, there is a need to value the STRIPS for accounting the same in the books of the participant wherever such bonds are not traded in the secondary market. In such cases, whenever STRIPS are acquired by stripping of balances held in SGL accounts, the discounted value of STRIPS will be arrived at, based on the zero coupon yields published by FIMMDA.

13. STRIPS will be reckoned as eligible government securities for SLR purposes and retain all the characteristics of Government Security. They will be eligible securities for market repo as well as repo under LAF of RBI but with appropriate haircut.

14. STRIPS, being zero coupon securities, trade at a discount and are redeemed at face value. Thus, STRIPS will have to be valued and accounted for as zero coupon bonds and in the manner prescribed in the DBOD Master Circular dated July 1, 2008 on prudential norms for classification, valuation and operation of investment portfolio by banks.

Trading in STRIPS

15. To begin with, STRIPS will be tradable only in the OTC market. Hence, trades in STRIPS will have to be struck in the OTC market and reported on NDS for clearing and settlement through CCIL.

Fees & Charges

16. Reserve Bank will not charge any fees for stripping/reconstitution of Government Securities. Further, to begin with, PDs, who are the “authorized entities” for authorizing requests for stripping/reconstitution in the PDO-NDS may also not charge the participants for carrying out this activity.

ISIN for STRIPSStructure:

I	N			M	M	Y	Y				
Country code	Issuer type/state code		Month and year of maturity of the STRIP				Security type	Subsequent strips/series serial number		Checksum digit	

Example of a CG Principal STRIP maturing in March 2009:

I	N	0	0	0	3	0	9	P	0	1	
Country code	Issuer type/state code		Month and year of maturity of the STRIP				Security type	Subsequent strips/series serial number		Checksum digit	

Example of a CG Coupon STRIP maturing in March 2009:

I	N	0	0	0	3	0	9	C	0	1	
Country code	Issuer type/state code		Month and year of maturity of the STRIP				Security type	Subsequent strips/series serial number		Checksum digit	

Nomenclature for Coupon STRIPS

GSddMONYYYYC; where C=Coupon STRIP, GS=Government Security and ddMONYYYY=date of maturity of the STRIPS (Ex. A coupon STRIP maturing on March 25, 2008 would be written as **GS25MAR2008C**)

Nomenclature for Principal STRIPS

x.xx%GSddMONYYYYYP; where x.xx is the coupon of the parent security from which the principal STRIP has been generated, ddMONYYYY=date of maturity of the STRIPS, GS=Government Security, and P=Principal STRIPS (Ex. A principal STRIP generated from, say, 7.99%2018 maturing on 02 July 2019 will be written as **7.99%GS02JUL2019P**)

Annex 2

Strippable Securities

Security	Date of Maturity
9.39% 2011	2-Jul-11
12.30 % 2016	2-Jul-16
5.64 % 2019	2-Jan-19

Investor "A"

Portfolio as on June 16, 2008

Security	Rs. (Cr)
9.39% 2011	100.00
12.30 % 2016	250.00

On June 17, 2008 strips Rs.5 Cr worth of 9.39%2011 & Rs.10 Cr worth of 12.30%2016

STRIPS generated

9.39% 2011		
Coupon STRIPS #	2-Jul-08	2,347,500
	2-Jan-09	2,347,500
	2-Jul-09	2,347,500
	02 Jan 10	2,347,500
	02 July 10	2,347,500
	02 Jan 11	2,347,500
	02 July 11	2,347,500
Principal STRIP	02 July 11	50,000,000

Each coupon strip = $(9.39\%/2) \times 5$ Cr.

12.30 % 2016		
Coupon STRIPS #	2-Jul-08	6,150,000
	2-Jan-09	6,150,000
	02 July 09	6,150,000
	02 Jan 10	6,150,000
	02 July 10	6,150,000
	02 Jan 11	6,150,000
	02 July 11	6,150,000
	02 Jan 12	6,150,000
	02 July 12	6,150,000
	02 Jan 13	6,150,000
	02 July 13	6,150,000
	02 Jan 14	6,150,000
	02 July 14	6,150,000
	02 Jan 15	6,150,000
	02 July 15	6,150,000
	02 Jan 16	6,150,000
02 July 16	6,150,000	
Principal STRIP	02 July 16	100,000,000

Each coupon strip = $(12.30\%/2) \times 10$ Cr.

Portfolio as on June 18, 2008

Security	Amount (Rs.)
9.39% 2011	950,000,000
12.30 % 2016	2,400,000,000
CS 02 July 08	8,497,500
CS 02 Jan 09	8,497,500
CS 02 July 09	8,497,500
CS 02 Jan 10	8,497,500
CS 02 July 10	8,497,500
CS 02 Jan 11	8,497,500
CS 02 July 11	8,497,500
CS 02 Jan 12	6,150,000
CS 02 July 12	6,150,000
CS 02 Jan 13	6,150,000
CS 02 July 13	6,150,000
CS 02 Jan 14	6,150,000
CS 02 July 14	6,150,000
CS 02 Jan 15	6,150,000
CS 02 July 15	6,150,000
CS 02 Jan 16	6,150,000
CS 02 July 16	6,150,000
PS 02 July 11	50,000,000
PS 02 July 16	100,000,000

CS=Coupon STRIPS; PS=Principal STRIP

RESERVE BANK OF INDIA

CENTRAL OFFICE

MUMBAI

Draft Notification

Government Securities -

Separate Trading of Registered Interest and Principal of Securities (STRIPS)

IDMD. No. /2008-09

Mumbai, Dated ----, 2009

In exercise of the powers conferred vide Explanation to Section 11(2) of the Government Securities Act, 2006 read with Section 2(i) of the Act, the Reserve Bank of India hereby notifies that Stripping/Reconstitution of Government Securities shall be subject to the terms and conditions specified herein.

I. Definitions

a) **“STRIPS”** (Separate Trading of Registered Interest and Principal of Securities) are distinct, separate securities that are created from the cash flows of a Government Security and shall consist of -

- (i) Coupon STRIPS, where the single cash flow of the STRIP represents a coupon flow of the original security
- (ii) Principal STRIP, where the single cash flow of the STRIP represents the principal cash flow of the original security.

Explanation: Stripping of a security shall result in Coupon STRIPS for all outstanding coupon payments and one Principal STRIP for the redemption payment. Each STRIP accordingly becomes a zero coupon bond since it has only one cash flow at maturity. Each STRIP shall be a distinct Government security and shall have a separate and distinct International Securities Identification Number (ISIN).

- b) "Stripping" means the process of separating the cash flows associated with a regular government security i.e., each outstanding semi-annual coupon payment and the final principal payment into separate securities.
- c) "Reconstitution" means the reverse process of stripping, where the individual STRIPS, i.e., both coupon STRIPS and Principal STRIPS are reassembled to get back the original security.

d) **“Authorized entity”** means a Primary Dealer or any other entity recognized by the RBI to accept requests from the holders of Government securities for stripping/reconstitution of the securities and submission to the RBI.

II. Terms and Conditions on STRIPS

1. The process of Stripping/Reconstitution of Government Securities shall be carried out at RBI, Public Debt Office in the PDO-NDS (Negotiated Dealing System).

2. All dated Government Securities having coupon payment dates on 2nd January and 2nd July, irrespective of the year of maturity shall be eligible for Stripping/Reconstitution.

3. All Coupon STRIPS with the same maturity date shall have the same ISIN, regardless of the underlying security from which the interest payments were stripped, and coupon strips of the same cash flow shall be fungible (interchangeable). The ISIN of Coupon STRIPS shall be different from the ISIN of Principal STRIPS, even if they have the same maturity date, and shall not be fungible.

4. Stripping/Reconstitution may be done at the option of the holder at any time from the date of issuance of a Government Security till its maturity.

5. Stripping/Reconstitution shall be permitted only in the eligible Government securities held in Subsidiary General Leger (SGL)/Constituent Subsidiary General Ledger (CSGL) accounts maintained at Public Debt Office, RBI, Mumbai. Physical securities shall not be eligible for Stripping/Reconstitution.

6. Holders of Government Securities shall place their requests for Stripping/Reconstitution with an “authorized entity”.

7. Reserve Bank will not charge any fees on Stripping/Reconstitution.

8. The amount of securities that could be tendered for Stripping/Reconstitution shall be a minimum of Rs.1 Crore and multiples thereof.

9. These terms and conditions shall come into effect from the date of this Notification.